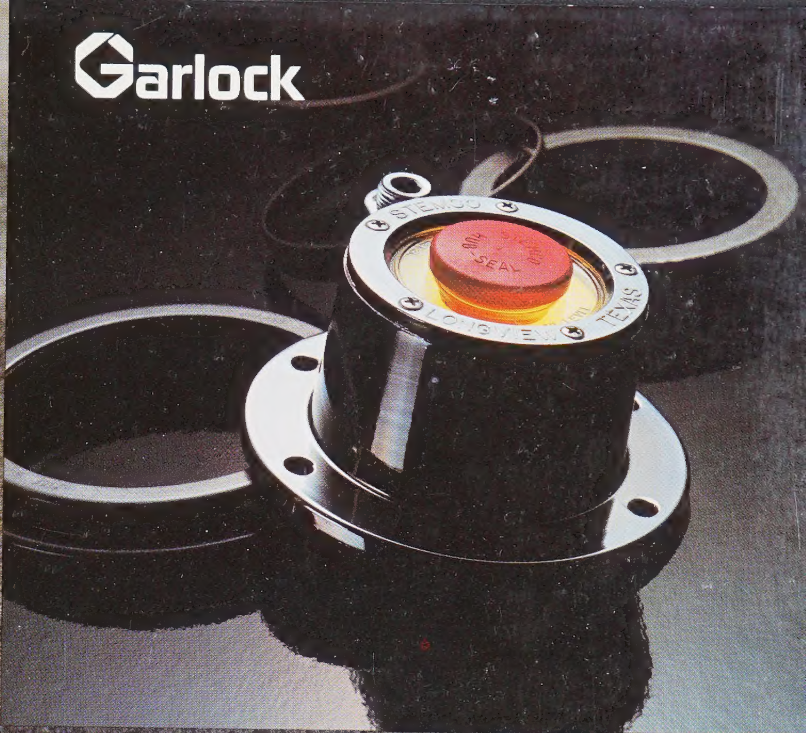
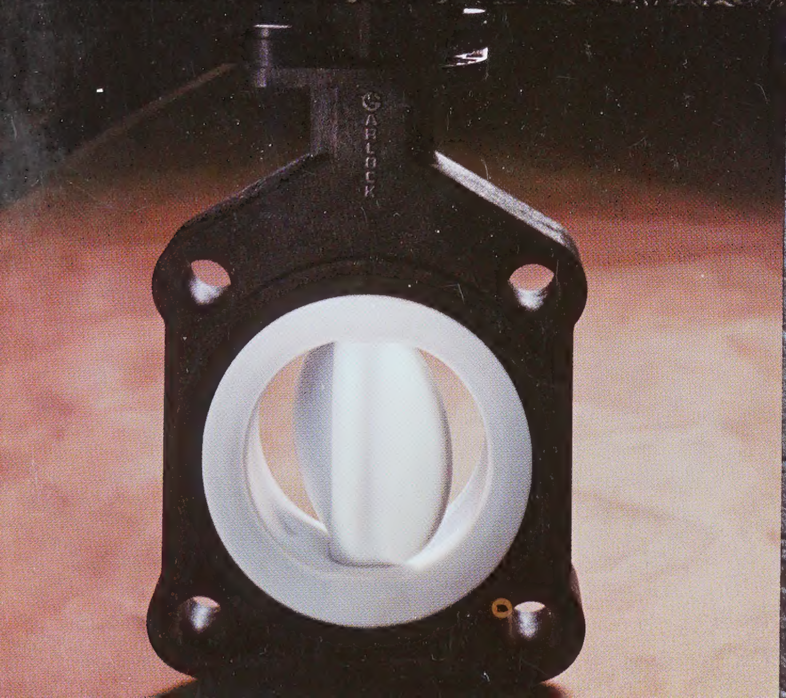
1974 Annual Report

Garlock





Garlock's Business

Garlock was organized in 1887 to manufacture devices used to control leakage. Through acquisitions and internal product development programs, the company has continually added other engineered components, primarily for piping, machinery or transportation applications. These more than 100,000 products are related by function, manufacturing technology, customer or a combination of these.

A common characteristic of all Garlock parts is that they are consumable; they wear out during the life of the product in which they are installed. Since much of this replacement business is distributed by original equipment manufacturers, exact figures are difficult to obtain, but we estimate that half of our products are used for maintenance.

Sales are not seasonal and are made to over 35,000 industrial customers. This breakdown of sales for the past two years shows the major industrial markets served:

	1974	1973
Machinery	15%	19%
Pumps & Compressors	11%	10%
Passenger cars	8%	11%
Transportation Equipment	19%	16%
Distributors	26%	24%
Government	1%	1%
All other	20%	19%
	100%	100%

No one customer or group of customers is material to our business. Company salesmen, representatives or agents, and distributors sell in more than 80 countries. Company-owned distributing companies are in all of the major industrial countries of Western Europe, Mexico and Australia.

Competition is fragmented; Garlock knows of no other company of similar size that is directly competitive in terms of diversity of products and markets. Divisions of other larger companies and small single product companies make and sell products similar to Garlock's.

Plants employing 5,868 people at year-end are located in the United States, Canada, France, Great Britain, Mexico, Belgium and Australia, with an affiliate in Japan. Products made outside the United States are similar to those made domestically.

Our manufacturing processes involve plastics, rubber, metal, textiles, asbestos, chemicals, leather or a combination of these. Since these raw materials are widely available, our business is not dependent on a limited number of suppliers. Because most of the products are producible in a short time, and because many are sold from inventory, backlogs are not significant to Garlock.

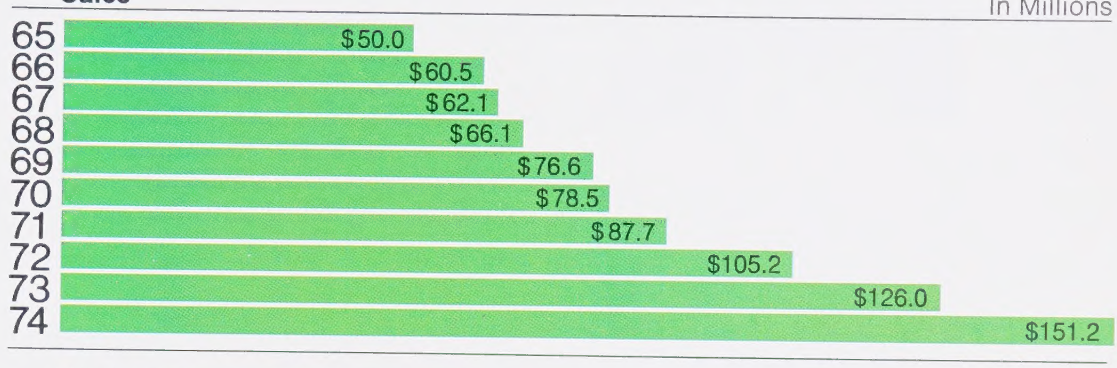
In recent years about a third of sales were to customers outside the United States; these are slightly more profitable than domestic. About 5-8% of sales in recent years were exports from the United States; a negligible amount of products or materials are imported into the United States.

Research and development is exclusively product development oriented and amounts to less than 1% of sales. We are not dependent on any patent, license or contract for a material portion of our business. Throughout its history more than 95% of Garlock's revenues and profits have been derived from this single line of business, providing the technological and productive resources to produce a wide range of engineered industrial components.

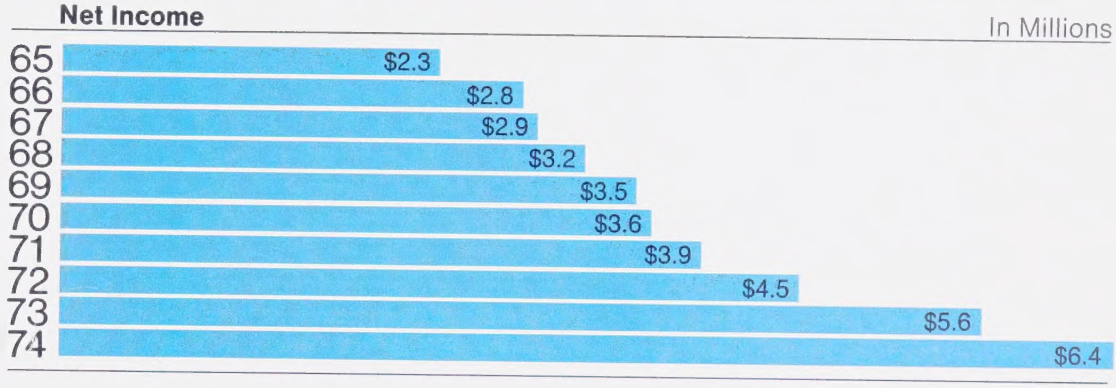
Financial Highlights

	1974	1973	Change
Sales	$151,168,000	$126,022,000	+20%
Net Income	$6,430,000	5,592,000	+15%
Net Income Per Share	$2.70	2.35	+15%
Dividends Per Share	$.86	$.84	+ 2%

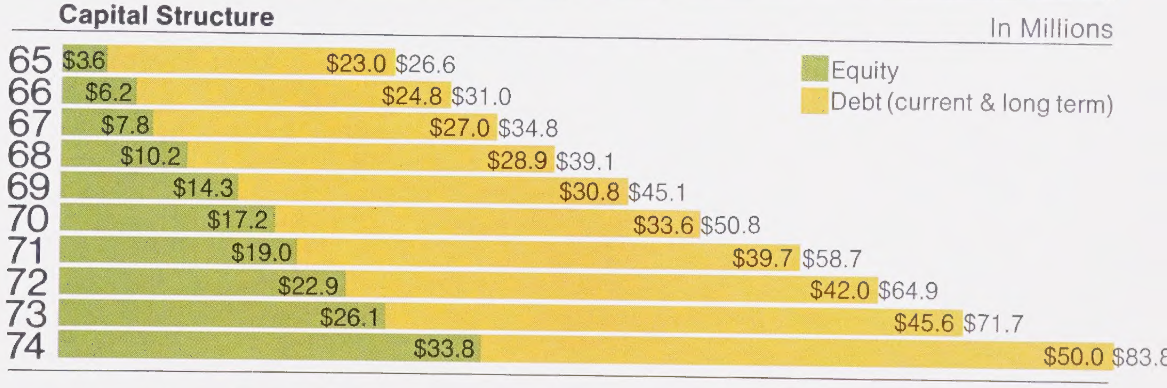
Sales



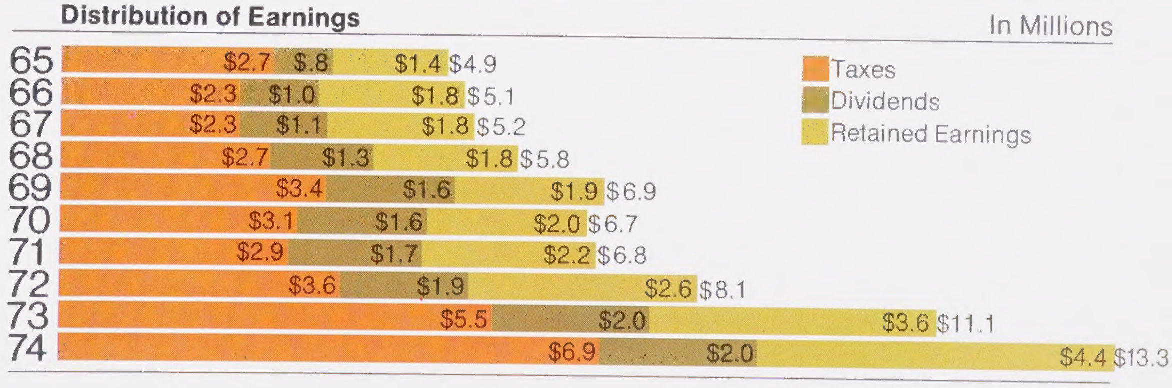
Net Income



Capital Structure



Distribution of Earnings



Letter to Shareholders

1974 was the fourteenth consecutive year of earnings growth. Earnings not only continued the growth started in 1961 but gained momentum in 1974, despite domestic price controls in the early part of the year, rapidly increasing costs of raw materials and labor, and severe energy shortages throughout the world.

Net income for 1974 rose 15% to $6,430,000, or $2.70 per share, after adopting the LIFO (Last-in, First-out) method of valuation for certain of our domestic inventories, compared to $5,592,000, or $2.35 per share, in 1973.

Sales of $151,168,000 increased 20% over the $126,022,000 reported in 1973.

Had we not elected to adopt LIFO accounting, our 1974 earnings would have been 28% higher than in 1973, or $7,139,000 equal to $3.00 per share.

LIFO accounting for inventories is a method of matching the most recent costs of production with current sales. During an inflationary period, the use of LIFO results in reporting lower profits and, therefore, lower taxes. Because of lower taxes on lower earnings, cash flow increases and simultaneously the value of inventories is understated as compared with other methods of inventory valuation.

Pre-tax profit margins or return on sales were 8.8% both in 1973 and 1974. If the change to LIFO accounting had not been made in 1974, the pre-tax margin would have been 9.8% last year; in other words, our operating performance would have been substantially better.

These 1974 results show Garlock's ability to grow in different world economies by selecting industrial markets and geographic regions which often run counter to the national pattern.

Business outside the United States continued its dramatic expansion again in 1974, representing 35% of corporate sales and 45% of total earnings compared to 30% and 41% in 1973. While our European plants and distributors are still the largest volume area of our international operations, we also experienced significant growth elsewhere as in Canada, Mexico and Australia. This is partially representative of the trends in world industrialization, but it also reflects our aggressiveness in being there with the products and services to meet various industrial requirements.

The relationship of sales to original equipment manufacturers and to the maintenance and repair after-market was 45-55% last year versus the general 50-50% relationship which has existed in recent years.

The annual dividend payment was increased again last year to $.86 per share from $.84 in 1973, reflecting the rate increase to $.22 from $.21 per share in the third quarter. Garlock has had a higher dividend payment each year since 1971, despite the company's cash requirements for growth.

Acquisition of property, plant and equipment during 1974 amounted to $8.8 million versus $4.5 million in 1973. This year these expenditures are budgeted at approximately $7 million. Our program for additions to productive capacity is continuing at this high level because of projected requirements not just this year but in years ahead.

The Board of Directors has proposed, for shareholders approval at the annual meeting in April 1975, changes to the Garlock Pension Plan which will increase past service benefits and also will bring the Plan into conformance with future requirements of the new Federal pension legislation adopted in 1974. A complete description of the proposed changes is contained in the proxy statement being mailed to each shareholder.

In 1974 the U.S. Supreme Court declined our petition for review of the adverse decision in 1973 by the Court of Appeals for the Second Circuit in our suit against the Commissioner of Internal Revenue on a technical point of tax law involving the income of an affiliate, Garlock, S.A., for the years 1964-65. The same legal issue remains open as to tax years subsequent to 1965, but the factual situations involved are somewhat different.

Despite the diverse expectations of well-recognized economists, we believe that our growth momentum can continue in 1975. The world's ability to reduce inflation is largely dependent on industry's increased production; and Garlock's products are generally essential to that. Political decisions will continue to cause fluctuations in basic economics, but our future is still optimistic and growth oriented.

The Securities and Exchange Commission in October 1974 issued important new disclosure requirements for annual reports of publicly owned corporations. While many of these content and presentation rules had been largely fulfilled by Garlock in prior years' reports, a brief review of some additions to this report might be helpful to some of our shareholders.

Our business description on the inside front cover has been expanded. The ten year summary of statistical data has been expanded and a brief description added. Also in this section of the report is a quarterly breakdown during the past two years of dividends paid as well as stock price highs and lows. A description of our Directors'principal business is now included under their listing on the inside back cover. Basically we are in agreement with the principle of improving information to our shareholders; and we believe that most of the new requirements are effective in doing that.

The following pages list some of the questions commonly asked of us during the past year as well as our answers. If you desire additional information on our operations, please write to us.

A. J. McMullen

B. H. Cook

A J McMullen

Chairman of the Board
Chief Executive Officer

B. H. Cook

President
Chief Operating Officer

February 28, 1975

Q&A

What are the main elements in the company's success in 1974?

The photographs in this report essentially give the answer. They show products which are indispensable wherever machinery is used, regardless of the economic climate. Our design capabilities and quality standards meet basic needs which continue to grow with world population and industrialization.

In addition, our manufacturing and marketing personnel around the world were able to provide essential engineering, repair or other services which often made the difference between customers purchasing a Garlock or a competitor's product.

Which markets and products showed the best gains for Garlock in 1974?

The 1974 growth was in several industries. It included products going into equipment for petroleum exploration, recovery and refining. Some of these products were hydraulic cylinders, compressor piston rings, and spiral-wound gaskets.

Last year the chemical and petro-chemical industries used many of the same products in their processes. Sealing and sound abatement products for both new trucks and those already on the road were in particularly heavy demand. Replacement truck leaf springs also participated in the strong truck maintenance market.

Replacement parts to maintain existing equipment in diverse industrial applications showed their traditional growth when sales to original equipment makers fell off. These products include oil seals, braided packings, and all the other products photographed in this report.

Which products declined in 1974, and why?

The sharp drop in purchases of consumer durables obviously was a negative factor for Garlock parts normally used in them. But new applications for TFE piston rings and other parts reduced the effect of lost oil seal, molded rubber and other consumer-related business.

Garlock supplies sealing products, not only for cars and trucks, but also for equipment used in manufacturing them. This market is likely to be depressed well into 1975, but we expect an upturn in demand later in the year which may provide us with some relief in our flat sales to the auto industry. Another area of slack was in major household appliances where demand was depressed by slow housing starts.

Are there compensating factors for the attrition in sales to original equipment makers?

A slowdown in demand for new products can actually quicken the flow of orders to Garlock to help maintain existing equipment on line. For example, we have seen various steel mills expedite maintenance programs for old machinery rather than add or replace them with new equipment. The after-market for Garlock products traditionally grows with the mainte-

Garlock was founded on the technology of braided packing materials. Today these materials continue to be the most widely accepted method for controlling leakage in pumps, valves, and many other industrial applications.

Q&A

nance requirements of machinery not replaced for economic reasons. This is one of the main factors in Garlock's stability and growth record.

How has the current recession affected Garlock prospects?

There are many uncertainties about 1975, but we are still optimistic about the prospects for another successful year. The after-market for our products—replacement parts for aging cars and manufacturing machinery, for instance—requires at least as much or more of Garlock production as any loss in original equipment manufactured. As a consequence, Garlock is less vulnerable to the effect of a recession than a company dependent on either maintenance sales or new equipment sales. We believe that the essential nature of our products and our strong financial position will enable Garlock to better pass through such a difficult period than many other companies.

Are production facilities operating at capacity?

Garlock plants are producing at between 75% and 85% of capacity. We are concentrating on high-margin items, with less attention to those producing small or no profits.

Does your 1974 sales increase reflect real growth, or is it caused mainly by inflationary price increases?

Most of our 1974 gains represent real growth in unit sales. Sales rose by 20% while our prices went up by less than half that rate—without an adverse effect on profitability.

With your automotive business down, why does Garlock continue to give special attention to this market?

The auto industry has developed and required excellent technology in seals and some of our other important products. These products are used by other industries. Therefore, our future as an industrial parts manufacturer is somewhat dependent on our ability to assist this particularly innovative industry in the development of other new products and variations on old ones.

Beyond this, we have faith. A slump in demand for automotive products is bound to be temporary and must be followed by a catch-up rush in orders. About 8.5 million cars are scrapped annually in this country, and they have to be replaced.

What is your research and development philosophy?

Garlock is not engaged in pure research, or research for its own sake, but we are quite active in product development—either on our own or with a major customer sharing this expense.

In general, new Garlock products are developed to meet specific customer needs rather than to make revolutionary products for which a need must be created. This application-oriented nature of our business is prudent for us as it benefits our customers, and thus our company's profitability.

Stemco products serve truckers. Truck oil wheel lubrication systems conserve maintenance dollars by lubricating wheel bearings in oil, eliminating downtime. They permit the easy visual check of oil levels and easy refill. Stemco also sells mufflers and other products for noise abatement.


STEMCO
LONGVIEW TEXAS
STEMCO
HUB-SEAL
KENWORTH
Stemco

Q&A

How does Garlock rank within American industry?

Continuing a trend of some years, the company again moved upwards on Fortune magazine's list of the 1,000 largest U.S. industrial companies for 1973 results. In terms of sales—Fortune's basic criterion for ranking—we were 748th, compared to 759th the year before.

Combined returns to shareholders, counting both stock price appreciation and cash dividends, averaged over 25% in the ten years ending with 1973, the most recent reporting year. This put Garlock 204th among the nation's industrial concerns. Earnings per share rose by 296% in that decade according to Fortune.

What competition does Garlock face in its markets?

In the multitude of seals and related component products, there is no directly comparable company; competition is fragmented. Small privately owned companies often compete in one or more products. In the same or other specific products, divisions of big publicly owned corporations have important market shares, but each of these has only a small segment of Garlock's overall coverage. The names of our competitors—Uniroyal, Federal Mogul, Raybestos Manhattan and Johns Manville, for instance—are significant. They each cover one segment of the market spectrum; Garlock has the broadest range of sealing-related products.

What is your acquisition policy?

We are actively interested in any product or product line that is compatible with our current operations, here or overseas. Garlock will continue to search for expansion opportunities that benefit its customers and its shareholders.

What are the criteria in evaluating acquisition candidates?

If a company's products are compatible with ours, we will consider the acquisition of a company with sales as small as $1 million. If a company's products are not related to existing Garlock products, but fit one of our existing industrial markets, the sales of the potential acquisition would have to be greater than $5 million.

What are Garlock's operating objectives?

We measure the performance of our profit center managers in large part by the financial return they achieve on the assets employed in their respective operations. In line with this objective, our aim is for net income to increase at a faster rate than sales.

Our managers are making a concentrated effort during these inflationary times to discontinue low margin products and to reduce the number of different products for the same application. This effort will make facilities available for growth items with higher profit margins without costly additional capital expenditures.

Our division and subsidiary managers present annual business opportunity plans which are reviewed by the corporate operating staff so that priorities can be placed on opportunities that can provide a maximum profitability growth for the corporation.

Spiral wound gaskets are used throughout industry where pipes, fittings and valves join to contain live steam and other fluids under high pressures or extreme heat.

Q&A

What are Garlock's growth prospects in foreign markets?

Garlock products and their marketing are well entrenched in most major non-communist countries and recent inroads have been made in several Eastern European countries. With this strong base of international operations, prospects for future development in foreign markets have never been better.

We continue to expect sales outside the United States to grow faster than domestic sales.

Ninety-six percent of the world's population is outside of the United States. As industry develops to support these people, we plan to expand with it. Therefore, much of our future growth opportunity will be abroad. The benefits to host nation and guest company, we think, are mutual.

Are you in Eastern Europe and in the Middle East?

Two years ago a team of Garlock sales engineers drove our European technical van to President Tito's former summer palace for one of the first product seminars ever held in Yugoslavia by a Western company. Since then we have expanded our coverage to Poland, Bulgaria, Czechoslovakia and Romania as well as Yugoslavia. In April we will exhibit at a trade show in Moscow.

For many years our export department has serviced Mid-Eastern countries; and now a separate marketing group is covering this area. Besides the obvious petroleum-related products we are also selling a wide range of products to other rapidly expanding industries.

What pressures do Garlock foreign subsidiaries face from their host countries?

Our policy is to have local nationals manage our foreign businesses. We service the needs of both established and emerging industries wherever we are located. These policies enhance our citizenship image. So our hosts tend to treat us more as a neighbor rather than as a foreign investor. Nevertheless, we recognize that multinational companies generally are facing new and increasing problems around the world and such exposure is likely to increase.

How do Garlock's multinational operations affect American jobs?

Our import-export trade actually creates American jobs! While only eight percent of our total output is exported, our exports have grown 240% during the past five years; imports to the United States are negligible. Furthermore, domestic jobs related to our export business are growing.

What are the prospects for labor disruptions in 1975?

Domestically we recently settled with our largest division on a one-year labor contract, and have only one other division contract to be renewed late this year.

Primarily in Western Europe—but elsewhere outside the United States as well—we participate in and abide by settlements of industry-wide bargaining units. Therefore, we can foresee no difficulties in our future world-wide labor relations.

These valves control pressures in large reciprocating compressors. Our France Products Division not only manufactures compressor-related components, but the division now has service centers throughout North America to rebuild them and to provide technical services to the petrochemical industry and others.


G

Q&A

How has Garlock stock performed during the past year?

While the stock price has slipped in the recent bear market, Garlock investors have done relatively well. Comparing year-end 1973 and year-end 1974, the Dow Jones Industrial Average and the Standard and Poor's 500 Stocks lost about 30% of their values. In the same period Garlock shares declined by 17% or about half of the loss suffered by the leading indicators. This, we believe, reflects investor confidence in Garlock as against other sound companies with good earnings records.

The stock market has not recognized Garlock's good earnings record. Why?

Although we believe our stock market record during the past year was above average, we see room for improvement, but stock market conditions will make improved recognition difficult. Individual investors have left the stock market in dramatic numbers in recent years. This trend means that stock trading in most stocks, including Garlock, depends on institutions such as banks, insurance companies and mutual funds. During the recent bear stock market even these institutions have forsaken stocks in favor of bonds and other investments. Even if the institutions were to return to the stock market, Garlock does not have sufficient shares available to satisfy the demands of institutions for a liquid trading market. Today Garlock stock depends on trading by individuals who are still interested in stocks as an investment.

What are the prospects for Garlock stock in the future?

Based on the expectation of continued sales and earnings gains, we anticipate a steady, but not dramatic, rise of our stock in the marketplace. The reason is that Garlock sales and earnings improvements have been consistent, not volatile.

Will increased capital requirements tend to stagnate dividend payout?

As Garlock sales grow, additional capital will be required for new productive capacity, more inventories and the other elements that support sales growth, but our capital requirements are not out of proportion with this sales growth. Therefore, we expect to maintain the company's record of steady increases in dividends per share. Our ability to increase dividends per share 250% over the past 10 years has been made possible by generating the capital necessary to perpetuate our growth.

Will increased earnings be reflected in future dividends?

Cash payout, in keeping with traditional policy, will continue to rise as fast as earnings allow. Because our business is less vulnerable than most companies to the effects of economic cycles, dividends may be expected to continue their steady increases.

In addition, our policy of reinvesting more of our earnings in the business than we pay in dividends will continue to enhance the market value of Garlock shares. This will benefit not only our stockholders, but also the national economy as the resulting productivity improvement helps reduce inflation.

Oil seals are frequently used around rotating shafts to keep lubricants in and contaminants out. These seals are used not only in new equipment, but to maintain old equipment from lawnmowers and outboard motors to huge industrial machinery.

Q&A

You adopted a dividend reinvestment program. Why?

This service was started in 1974 in recognition of a special obligation by the company to its investors to facilitate the enhancement of their Garlock holdings. Shareholders may also invest additional cash under the plan in Garlock stock. By sharing administrative expenses and participating in block purchases, participants in this program are usually able to buy Garlock stock at a lower cost than they otherwise could by alternative means.

How effective was Garlock's 1974 corporate advertising?

Our 1974 advertising campaign in national business publications produced more than twice the requests for annual reports and other materials as in past years, despite a difficult investment climate. This indicates a substantial broadening of investor interest in the company and therefore an enlarged base market for our shares. While inquiries came from both individuals and professional investors, the main purpose was to enlarge individual investor awareness of Garlock. We believe this was achieved.

Is corporate advertising planned in 1975?

Because of the cash requirements of most of our operating divisions and subsidiaries, the budget for corporate advertising for 1975 was reduced. Since corporate recognition was improved in 1974, our management feels that the program should be continued on a limited basis.

Does Garlock have difficulty purchasing raw materials?

Since late last year we have experienced improved deliveries and price weaknesses in many raw materials. Last year we had some severe shortages which required our managers to improvise. The outlook for 1975 purchasing is certainly better.

What is LIFO and what is Garlock's position relative to LIFO?

LIFO (last-in, first-out) is a method of inventory valuation which more properly matches current costs with current revenues in inflationary times and also creates a cash flow advantage for the company during such periods.

With the very rapid rate of inflation in 1974, Garlock adopted LIFO for a substantial portion of domestic inventory as indicated in our financial statements. In some of our units there was no significant cash flow advantage and, therefore, we elected to continue our previous method of "average cost" inventory accounting. Of course we will continue to evaluate our position every year.

What is Garlock's world-wide borrowing policy?

Our basic philosophy is that a third of our total capital is obtained from borrowed funds. Outside of the United States we tend to follow the normal practice in this regard in each nation where we have operations. To the extent that foreign capital structures are different from those found in the United States, this could result in changes on a consolidated basis.

Plastic-lined butterfly valves control the flow of corrosive fluids. Our standard valve for many years was lined with TFE. Our newest line uses du Pont's new Hytrel with bodies of a rugged reinforced thermoplastic, making them 70% lighter than ordinary cast metal butterfly valves.


GARLOCK

Statement of Consolidated Income and Retained Earnings

Garlock Inc. and Consolidated Subsidiaries

	52 Weeks Ended December 29, 1974	52 Weeks Ended December 30, 1973
Income		
Sales	$151,167,705	$126,021,620
Operating costs:		
Cost of goods sold	101,557,474	84,236,839
Selling and administrative expenses	32,876,751	28,149,560
Total operating costs	134,434,225	112,386,399
Income from operations	16,733,480	13,635,221
Sundry charges—net	3,390,384	2,576,357
Income before taxes on income	13,343,096	11,058,864
Taxes on income	6,912,634	5,467,230
Net Income for the Year	$ 6,430,462	$ 5,591,634
Average shares outstanding	2,377,309	2,376,929
Earnings Per Share	$ 2.70	$ 2.35
Retained Earnings		
Retained Earnings, beginning	$ 37,438,112	$ 33,843,082
Net income for the year	6,430,462	5,591,634
Dividends on common stock (1974—$.86; 1973—$.84)	(2,044,485)	(1,996,604)
Retained Earnings, ending	$ 41,824,089	$ 37,438,112

The accompanying notes are an integral part of this statement.

Opinion of Independent Certified Public Accountants

Garlock Inc., its Shareholders and Directors:

We have examined the statements of consolidated financial position of Garlock Inc. and its consolidated subsidiaries as of December 29, 1974 and December 30, 1973 and the related statements of consolidated income and retained earnings and of changes in consolidated financial position for the fifty-two week periods then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Garlock Inc. and its consolidated subsidiaries at December 29, 1974 and December 30, 1973 and the results of their operations and the changes in their financial position for the fifty-two week periods then ended, in conformity with generally accepted accounting principles applied (except for the change, with which we concur, in the method of determining cost for certain inventories as explained in Note 10 to the financial statements) on a consistent basis.

800 Midtown Tower
Rochester, New York 14604
February 17, 1975

Haskins & Sells

Statement of Consolidated Financial Position

Garlock Inc. and Consolidated Subsidiaries

	December 29, 1974	December 30, 1973
Current Assets:		
Cash	$ 1,810,968	$ 1,880,175
Accounts receivable (Less allowance: 1974—$408,695; 1973—$321,899)	28,892,479	21,745,930
Inventories	40,871,728	31,510,041
Prepaid expenses	777,452	915,112
Total current assets	72,352,627	56,051,258
Less Current Liabilities:		
Notes payable and current portion of long-term debt	10,808,252	6,223,023
Accounts payable and accrued expenses	19,214,238	11,818,420
U.S. and Foreign taxes on income	2,567,228	2,657,771
Total current liabilities	32,589,718	20,699,214
Working Capital	39,762,909	35,352,044
Other Assets:		
Property, plant and equipment—net	33,501,365	28,224,361
Deferred charges, sundry investments	1,332,687	2,079,032
Excess of investment in subsidiaries over book value of net assets	5,790,532	5,762,029
Total other assets	40,624,584	36,065,422
Assets Less Current Liabilities	80,387,493	71,417,466
Less Other Liabilities:		
Long-term debt	23,001,103	19,923,641
Deferred taxes on income and other credits	2,083,559	940,819
Other liabilities	2,724,851	2,600,326
Total other liabilities	27,809,513	23,464,786
Excess of Assets Over Liabilities	$52,577,980	$47,952,680
Shareholders' Ownership:		
Minority interest in subsidiaries	$ 2,545,507	$ 2,306,290
Garlock Inc. shareholders:		
Preferred stock (authorized 300,000 shares of $1 par value each, undesignated; issued, none)	—	—
Common stock (authorized 5,000,000 shares of $1 par value each, issued: 2,415,444 shares)	2,415,444	2,415,444
Excess of shareholders' investment over par value of common stock	6,446,214	6,446,108
Retained Earnings	41,824,089	37,438,112
	50,685,747	46,299,664
Less treasury stock at cost (38,135 shares)	653,274	653,274
Total ownership—Garlock Inc. shareholders (Outstanding: 2,377,309 shares)	50,032,473	45,646,390
Total	$52,577,980	$47,952,680

The accompanying notes are an integral part of this statement.

Statement of Changes in Consolidated Financial Position

Garlock Inc. and Consolidated Subsidiaries

	52 Weeks Ended December 29, 1974	52 Weeks Ended December 30, 1973
Sources of Working Capital		
From operations:		
Net income	$ 6,430,462	$ 5,591,634
Depreciation and amortization	3,337,365	2,918,128
Deferred income taxes	988,621	359,259
Pension expense	—	500,000
Minority interest in net income	398,335	254,127
Loss on disposition of property, plant and equipment	123,437	17,305
Other—net	146,298	30,116
Total from operations	11,424,518	9,670,569
Decrease in deferred charges and sundry investments	1,155,239	—
Sales and retirement of property, plant and equipment	88,739	432,138
Sale and issuance of treasury stock	—	7,906
Increase in long-term debt	6,721,240	6,878,457
Increase in minority interest	—	238,238
Increase in other credits	154,150	89,949
Total	$19,543,886	$17,317,257
Dispositions of Working Capital		
Cash dividends	$ 2,044,485	$ 1,996,604
Acquisition of property, plant and equipment	8,844,492	4,544,557
Increase in deferred charges and sundry investments	405,299	1,132,488
Reduction in long-term debt	3,643,778	3,944,113
Excess of investment in acquisitions over book value of net assets	35,849	—
Decrease in minority interest	159,118	—
Increase in working capital	4,410,865	5,699,495
Total	$19,543,886	$17,317,257
Changes in Working Capital Components		
Current assets:		
Cash	$ (69,207)	$ 559,055
Accounts receivable	7,146,549	3,745,216
Inventories	9,361,687	5,481,735
Prepaid expenses	(137,660)	6,894
Increase in current assets	16,301,369	9,792,900
Current liabilities:		
Notes payable and current portion of long-term debt	4,585,229	350,099
Accounts payable and accrued expenses	7,395,818	2,435,447
U.S. and Foreign taxes on income	(90,543)	1,307,859
Increase in current liabilities	11,890,504	4,093,405
Increase in working capital	$ 4,410,865	$ 5,699,495

The accompanying notes are an integral part of this statement.

Notes to Financial Statements

Note 1 | Accounting Policies

A summary of the significant accounting policies followed by the Company in preparation of the accompanying consolidated financial statements is set forth below:

Basis of Consolidation: The Company follows the practice of consolidating all subsidiaries except in unusual circumstances. All material intercompany balances and transactions have been eliminated.

Currency Translation: The Company follows the monetary/non-monetary approach in valuing foreign assets and liabilities in all material respects. Assets and liabilities are translated into United States dollars at fiscal year-end rates of exchange except inventories, property, plant and equipment, and related accumulated depreciation which are translated at historical rates. The income statement accounts of foreign subsidiaries are translated into United States dollars using average rates of exchange in effect during the year. Exchange adjustments, including those resulting from performed and unperformed forward exchange contracts, are included in the results of operations for the year after establishment of reserves for anticipated future changes. The effect on income and the reserves established have not been material.

Research and Development Costs: The Company has not engaged in any major research and development programs. Such costs are product development oriented and are charged against income as incurred.

Lease Purchase Agreements: Lease agreements which are substantially installment purchases of property have been recorded as assets and are being depreciated over their estimated useful lives in accordance with Accounting Principles Board Opinion No. 5.

Property, Plant and Equipment: Property, plant and equipment are carried at cost. Depreciation for financial reporting purposes is computed principally under the straight-line method and under accelerated methods for tax purposes where practical.

Maintenance and repairs are charged to expense as incurred. Renewals and replacements of a routine nature are charged to expense while those which improve or extend the life of existing properties are capitalized. The cost and related accumulated depreciation of items sold or retired are removed from the accounts with any resulting gain or loss being included in operations for the period.

Income Taxes: Provisions for income taxes are based on the tax effects of transactions which are included in the determination of pre-tax accounting income with appropriate recognition made for deferred income taxes. No provision has been made for additional taxes that might result from the distribution to the Company of retained earnings of consolidated foreign subsidiaries inasmuch as a substantial portion of these retained earnings has been reinvested in the foreign operations. See Note 2.

The U.S. investment tax credits are applied to reduce the provision for income taxes for the year in which the related properties are acquired ("flow through" method).

Inventories: In 1974, the Company adopted the LIFO (Last-in, First-out) method of valuing certain inventories—See Note 10 for the effect of this change. The remaining portion of 1974 inventories is stated generally at the lower of average cost or market.

Inventories at the end of 1973 were stated generally at the lower of average cost or market.

Intangibles: The excess of investment in subsidiaries over book value of net assets consists of:

a) Goodwill purchased prior to November 1, 1970, which is amortized only when management believes that there has been a diminution in value.
b) Goodwill purchased after October 31, 1970, which is being amortized, on a straight-line basis, over a period not exceeding 40 years.

Charges or credits to income have not been material in any year.

Pensions: The Company has pension plans covering substantially all employees in the United States, Canada, and certain other foreign countries. The Company's policy is to fund pension costs based on recommendations of its consulting actuaries.

Note 2 | Foreign Operations

Net assets employed in foreign operations

are summarized below together with sales and net income from these operations.

	Fiscal Year Ended 1974	1973
Current assets	$32,025,000	$19,756,000
Less current liabilities	14,623,000	8,480,000
Working capital	17,402,000	11,276,000
Other investments and sundry assets	1,641,000	2,026,000
Property, plant and equipment, net	11,228,000	7,954,000
	30,271,000	21,256,000
Long-term debt	2,738,000	2,578,000
Other liabilities and credits	1,774,000	1,007,000
Minority interest	2,545,000	2,306,000
	7,057,000	5,891,000
Garlock net assets employed in foreign operations	$23,214,000	$15,365,000
Sales from foreign operations	$52,184,000	$37,496,000
Net income from foreign operations—net of minority interest	$ 2,910,000	$ 2,307,000

In accordance with the Company's policy (See Note 1) no income taxes have been provided on the undistributed earnings of foreign subsidiaries. The amount of such undistributed earnings totaled approximately $14,950,000 and $11,042,000 at the end of 1974 and 1973 respectively. If for some reason not presently contemplated such earnings were to be remitted or otherwise become subject to U.S. income tax, available tax credits would substantially reduce the amount of tax otherwise due.

Note 3 | Property, Plant and Equipment

The major classifications of property are as follows:

	1974	1973
Land	$ 1,742,735	$ 1,581,020
Buildings and improvements	17,238,054	14,904,508
Machinery and equipment	44,182,367	38,894,447
Total	63,163,156	55,379,975
Less accumulated depreciation	29,661,791	27,155,614
Net property	$33,501,365	$28,224,361

Note 4 | Inventories

Inventories reflect the following classifications:

	1974	1973
Finished, semi-finished and in process	$30,957,791	$23,757,157
Raw materials and supplies	9,913,937	7,752,884
Total	$40,871,728	$31,510,041

Inventories on the LIFO (Last-in, First-out) method in 1974 amounted to approximately 21% of total inventories. The remainder of 1974 inventories and 1973 inventories are generally on the average cost method.

Under LIFO, 1974 inventories are valued at approximately $1,485,000 below average cost.

Note 5 | Long-Term Debt

Long-term debt consists of the following:

	1974	1973
7.90% (effective average rate) Notes payable to insurance company in installments to 1988	$20,400,000	$17,650,000
13.45%-1974; 8.38%-1973 Note payable to bank under a revolving credit agreement expiring in 1979	449,969	1,505,000
5.50% to 13.05% Real Estate mortgages payable in installments to 1993	2,847,778	1,038,202
Other	1,052,063	1,458,388
	24,749,810	21,651,590
Less current portion	1,748,707	1,727,949
Total	$23,001,103	$19,923,641

The notes payable to the insurance company contain certain restrictions on dividends. The retained earnings free of restrictions at December 29, 1974 were $8,009,000 and $5,100,000 at December 30, 1973. Total interest expense was $2,921,000 and $1,871,000 in 1974 and 1973 respectively.

The Company entered into a new loan agreement on January 8, 1975 relating to its notes payable to an insurance company in installments to 1988. The new agreement combines a new loan of $5,600,000 with the existing loan of $20,400,000. Under the new loan agreement, the $26,000,000 note is due March 1, 1990, bears interest at the rate of 8.875% per annum and requires total annual principal payments of $500,000 in 1976, $1,000,000 in 1977, $1,500,000 in 1978, and $2,000,000 thereafter until 1990 when the remaining balance is due. The new agreement provides for similar covenants and restrictions as existed under the previous agreement. Proceeds from the new loan agreement were applied, for the most part, to the reduction of short-term notes payable to banks.

Note 6 | Stock Options

At December 29, 1974, 72,950 shares of common stock were reserved for issuance

under the Company's stock option plan. Of these shares, 71,450 were reserved against outstanding options ranging in price from $13.69 to $21.88. These options expire at various dates from July 23, 1975 to December 18, 1978. Options were exercisable with respect to 57,700 shares. During 1974, no options were exercised and no options were cancelled.

At December 30, 1973, 72,950 shares of common stock were reserved for issuance under the Company's stock option plan. Of these shares, 71,450 were reserved against outstanding options ranging in price from $13.69 to $21.88. These options expire at various dates from July 23, 1975 to December 18, 1978. Options were exercisable with respect to 34,575 shares. During 1973, options for 550 shares were exercised at a price of $14.38 and aggregated $7,906, and six options with respect to an aggregate of 10,000 shares were cancelled.

Note 7 | Pension Plans

Total pension expense was $725,000 and $608,000 in 1974 and 1973 respectively. The prior service cost has been fully provided and funded in prior years.

Note 8 | Rent Expense and Lease Commitments

Rent expense amounted to $1,757,000 in 1974 and $1,335,000 in 1973. Rentals on non-capitalized financing leases included in these amounts were $493,000 and $426,000 in 1974 and 1973 respectively. The approximate minimum rental commitments under noncancellable leases are as follows:

	Total	Financing Leases (Principally Machinery and Motor Vehicles)	Other Leases (Principally Real Estate)
1975	$1,317,000	$ 492,000	$ 825,000
1976	949,000	475,000	474,000
1977	642,000	318,000	324,000
1978	316,000	114,000	202,000
1979	186,000	93,000	93,000
1980-1984	275,000	116,000	159,000
1985-1989	92,000	32,000	60,000
1990-1994	94,000	10,000	84,000
Total	$3,871,000	$1,650,000	$2,221,000

There would not have been a significant effect on the accompanying financial statements if the financing leases shown above had been capitalized.

Note 9 | Income Tax Expense

Deferred taxes relating to timing differences included in the provisions for income taxes totaled $989,000 and $359,000 for 1974 and 1973 respectively.

Note 10 | Change to LIFO Method of Inventory Pricing

In the fourth quarter of 1974, the Company changed its method of pricing certain domestic inventories from average cost to the LIFO (Last-in, First-out) method. This change was made to recognize the effect of inflation on inventory, and thereby more effectively match current costs with current revenues for both financial and income tax reporting purposes. Because the 1973 ending inventories are the opening 1974 LIFO inventories, there is no cumulative effect on retained earnings at the beginning of the year. Accordingly, pro forma results of operations for the prior year, had this principle been followed for such inventories in that period, are not determinable.

The effect of the change on the 12 months ended December 29, 1974 was to decrease net income $709,000 ($.30 per share).

The effect of the change on the first, second and third quarters of 1974 is as follows:

	Thirteen Weeks Ended March 31, 1974	June 30, 1974	Sept. 29, 1974
Net income as originally reported ..	$1,623,000	$1,774,000	$1,628,000
Effect of change to LIFO	(138,000)	(119,000)	(238,000)
Net income as restated	$1,485,000	$1,655,000	$1,390,000
Per share amounts:			
Net income as originally reported ..	$ .68	$ .75	$ .68
Effect of change to LIFO	(.06)	(.05)	(.10)
Net income restated ..	$ .62	$ .70	$ .58

Form 10-K

The Form 10-K Annual Report to the Securities and Exchange Commission provides certain additional information and will be available in April. A copy of this report may be obtained upon request to our Director of Investor Relations.

Ten Year Summary 1974–1965

Garlock Inc. and Consolidated Subsidiaries

	1974	1973
Consolidated Summary of Operations		
*Sales	151,168	126,022
*Cost of goods sold	101,557	84,237
*Selling and administrative expenses	32,877	28,150
*Interest charges	2,921	1,871
*Sundry charges (income)—net	470	705
*Income before taxes on income	13,343	11,059
*Taxes on income	6,913	5,467
*Net income	6,430	5,592
Average shares outstanding	2,377,309	2,376,929
Net income per share	$2.70	$2.35
Cash dividends per share	$ .86	$ .84
Financial Position Data		
*Current assets	72,353	56,051
*Current liabilities	32,590	20,699
*Working capital	39,763	35,352
*Net property, plant and equipment	33,501	28,224
*Long-term debt	23,001	19,924
*Garlock shareholders' ownership	50,032	45,646
Garlock shareholders' ownership per share	$21.05	$19.20
*Total borrowed capital	33,809	26,147
Other Data		
Number of shareholders (year-end)	5,060	5,242
Number of employees (year-end)	5,868	5,915
*Net income plus depreciation	9,768	8,510
*Expenditures on new plant	8,844	4,545
Net income to Garlock shareholders' ownership (beginning)	14.09%	13.30%
Net income to sales	4.25%	4.44%

*Thousands of dollars

Management's Discussion and Analysis of the Consolidated Summary of Operations

Sales grew to record levels, increasing at the rate of approximately 20% in each of the last two years, reflecting a relatively strong economy in all of the markets served by the company. While it is difficult to determine on a world-wide basis what portion of the growth was due to price increases, management believes, based on the monitoring of domestic price increases, that the larger portion of the growth represents the increase in volume.

The cost elements associated with the actual production and marketing of our products also increased in the same magnitude but at a slower rate, reflecting the fact that portions of these expenses represent fixed charges such as depreciation which do not increase with increased volume. The increase in the Cost of Goods and in the Selling and Administrative Expense amounted to 19% and 17% respectively in 1973 and 1974.

The most significant percentage change in 1974 as well as over the longer term has been in interest expense. This has been caused by two factors. As the company has increased its equity base over the years, it has continued to increase its debt at approximately the same rate. During 1974, however, in addition to the normal growth in the amount of debt capital, we have seen dramatic increases in interest rates. Although our interest expense is a relatively small component of our total costs, these two factors resulted in an

1972	1971	1970	1969	1968	1967	1966	1965
105,159	87,650	78,533	76,561	66,139	62,133	60,532	49,997
70,899	59,030	51,481	51,228	44,432	41,051	40,820	32,784
24,737	21,032	19,138	17,594	15,326	15,389	14,285	12,106
1,510	1,379	1,195	870	626	503	264	106
(63)	(593)	(10)	(80)	(68)	(29)	63	75
8,076	6,802	6,729	6,949	5,823	5,219	5,100	4,926
3,563	2,877	3,132	3,444	2,656	2,320	2,307	2,664
4,513	3,925	3,597	3,505	3,167	2,899	2,793	2,262
2,379,532	2,277,330	2,083,492	2,083,873	2,061,272	1,981,748	1,943,856	1,930,864
$1.90	$1.72	$1.73	$1.68	$1.54	$1.46	$1.44	$1.17
$ .81	$ .80	$ .80	$ .80	$ .70	$ .60	$ .575	$ .45
46,258	39,693	35,158	32,398	29,729	25,283	24,125	22,218
16,606	15,072	12,875	15,186	8,779	8,989	11,986	8,359
29,652	24,621	22,283	17,212	20,950	16,294	12,139	13,859
27,041	24,701	21,324	19,136	17,207	16,878	15,418	12,148
16,989	12,996	13,074	7,887	8,400	5,761	1,577	2,749
42,043	39,688	33,625	30,829	28,869	27,033	24,806	22,979
$17.69	$16.65	$15.72	$14.79	$14.04	$13.00	$12.73	$11.90
22,862	19,027	17,175	14,282	10,232	7,785	6,177	3,607
5,267	5,540	5,213	5,067	5,080	5,020	4,564	3,756
5,397	5,031	4,782	4,942	4,257	4,057	3,820	3,359
7,226	6,132	5,421	5,760	5,259	4,964	4,495	3,614
5,162	5,025	3,721	4,132	2,378	2,864	3,729	1,731
11.37%	11.67%	11.67%	12.14%	11.71%	11.69%	12.15%	10.49%
4.29%	4.48%	4.58%	4.58%	4.79%	4.67%	4.61%	4.52%

ncrease of over 50% in Interest Charges.

Sundry Charges can change dramatically n terms of percentages on a year-to-year basis although it represents an immaterial part of our total corporate costs of doing business. The change from 1973 to 1974 ($705,000 expense decreasing to $71,000 expense) was created by a combination of many factors. Some of the primary reasons for the change related to (a) more profitable operations n 1974 on the part of unconsolidated affiliates ($212,000 improvement) and (b) capital gains on sales of unused assets ($86,000).

Please refer to Note 10 to the financial statements for a description of the effect of the LIFO inventory accounting method on the 1974 profitability.

Per Share Data

1973	Stock Market* Price High	Stock Market* Price Low	Dividends Paid	Earnings Per Share
1st Quarter	$19.63	$16.50	$.21	$ .59
2nd Quarter	$19.13	$15.50	$.21	$ .62
3rd Quarter	$18.00	$15.50	$.21	$ .52
4th Quarter	$18.38	$12.50	$.21	$ .62
			$.84	$2.35
1974				
1st Quarter	$17.38	$14.00	$.21	$ .62**
2nd Quarter	$16.88	$14.38	$.21	$ .70**
3rd Quarter	$15.50	$14.00	$.22	$ .58**
4th Quarter	$14.38	$11.63	$.22	$ .80
			$.86	$2.70

*New York Stock Exchange
**Restated to reflect change to LIFO in 4th Quarter.

Operating Units

Oil Seal Group

Precision Seal Division
Gastonia, North Carolina

Service Spring Company
Indianapolis, Indiana

Spring Division
Bristol, Connecticut

Stemco Manufacturing Company Inc.
Longview, Texas

Mechanical Products Group

Coatings Division
Austin, Texas

Garlock of Canada Ltd.
Toronto, Ontario

Mechanical Rubber Division
Palmyra, New York

Mechanical Seal Division
Houston, Texas

Mechanical Power Group

France Packing of Canada Ltd.
Brantford, Ontario

France Products Division
Newtown, Pennsylvania
Philadelphia, Pennsylvania

Bearings Division
Cherry Hill, New Jersey

Plastics Division
Camden, New Jersey

Plastomer Division
Newtown, Pennsylvania

Fluid Power Group

Fluid Power Limited
Rexdale, Ontario

Ortman-Miller Division
Hammond, Indiana

International Group

Chromex, S.A.
Lardy, France

Garlock de Mexico, S.A.
Mexico City, Mexico

Liard S.A.
Roux, Belgium

Liard France S.A.
Jeumont, France
Mourenx, France

Victor Engineering Pty. Ltd.
Sydney, Australia

Woodville Rubber Company Ltd.
Ross-On-Wye, England
Burton, England

Arai Seisakusho Co., Ltd.
Tokyo, Japan
Tsukuba, Japan

Garlock A.G.
Winterthur, Switzerland

Garlock Benelux B.V.
Sliedrecht, Netherlands

Garlock GmbH
Dusseldorf, West Germany

Garlock (Great Britain) Ltd.
Newbury, England

Garlock Export Corporation
Palmyra, New York

Garlock International, Inc.
Palmyra, New York

Garlock, S.A.
Panama, Republic de Panama
Zurich, Switzerland
Barcelona, Spain
Tokyo, Japan

Louis Mulas Sucs S.A.
Mexico City, Mexico

Officers & Directors

Directors

John N. Abell
Vice President and Director
Wood Gundy Ltd.
Toronto, Ontario, Canada
Investment Banking Firm

Mortimer R. Anstice, Jr.
Retired Manufacturing Executive

Ben H. Cook
President and Chief Operating Officer
Garlock Inc.

Burt N. Dorsett
Executive Vice President and Trustee
College Retirement Equities Fund
New York, New York
Insurance Company

Donald A. Gaudion
Chairman and Chief Executive Officer
Sybron Corporation
Rochester, New York
Health Products, Instrumentation, Industrial Equipment and Chemical Manufacturer

John I. Gearhart
Investor and Financial Consultant

A. J. McMullen
Chairman and Chief Executive Officer
Garlock Inc.

Richard L. Turner
Chairman and President
Schlegel Corporation
Rochester, New York
Edge and Area Sealing Manufacturer

Herman H. Waggershauser
Director and Retired Vice President
Eastman Kodak Company
Rochester, New York
Photographic and Chemical Products Manufacturer

Schuyler C. Wells
Senior Investment Executive
Shearson Hayden Stone Inc.
Rochester, New York
Securities Brokerage Firm

Officers

A. J. McMullen
Chairman and Chief Executive Officer

Ben H. Cook
President and Chief Operating Officer

William R. Bow
Vice President—Administrative Staff Services

John E. Brennan
Vice President—Mechanical Power Group

Donald J. Camille
Vice President—International Group

John J. Grady
Vice President—Finance Group

G. Parry Wiess
Vice President—Operational Staff Services

Peter S. Hanke
Secretary and General Counsel

Robert E. Jeffery
Controller

Kenneth W. Smith
Treasurer

Dennis S. Bowler
Assistant Controller

John D. Lynn
Assistant Secretary

Harold D. Retting
Assistant Secretary and Assistant Counsel

Clinton O. Steadman
Assistant Treasurer

Transfer Agents

Security Trust Company of Rochester
One East Avenue
Rochester, New York 14604

Marine Midland Bank—New York
2 Broadway
New York, New York 10015

Registrars

Lincoln First Bank of Rochester
Rochester, New York

First National City Bank of New York
New York, New York

Dividend Disbursing Agent

Security Trust Company of Rochester
One East Avenue
Rochester, New York 14604

Independent Auditors

Haskins & Sells
800 Midtown Tower
Rochester, New York 14604

Stock Traded on

New York Stock Exchange
(Symbol—GAK)

Executive Offices

1250 Midtown Tower
Rochester, New York 14604
716/232-1400
Telex 978452

Annual Meeting

The annual meeting of shareholders will be at 2:00 p.m. on Tuesday, April 22, 1975, in the Auditorium of the Marine Midland Bank—Rochester, One Marine Midland Plaza, Rochester, New York

Garlock

Garlock Inc., 1250 Midtown Tower, Rochester, New York 14604